United States Court of Appeals

for the Second Circuit

RESPONDENT'S BRIEF

75-4046

BRIEF FOR RESPONDENTS

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 75-4046

AMERICAN TELEPHONE AND TELEGRAPH COMPANY,
Petitioner,

v.

FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA,
Respondents,

COMMONWEALTH OF PENNSYLVANIA, et al.,
Intervenors.

ON REVIEW FROM THE
FEDERAL COMMUNICATIONS COMMISSION

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BRIEF FOR RESPONDENTS FEDERAL COMMUNICATIONS COMMISSION and THE UNITED STATES OF AMERICA

STATEMENT OF ISSUE PRESENTED

Whether the Commission acted lawfully in rejecting a proposed tariff increase designed to raise the carrier's rate of return above the level which the Commission had prescribed after a full hearing pursuant to the applicable statute.

COUNTERSTATEMENT

American Telephone and Telegraph Company seeks review of an order of the Federal Communications Commission which rejected an interstate rate increase proposal on grounds that the Commission's prior prescription of a rate of return for the telephone company barred increases that were designed to produce a rate of return higher than the prescribed level. American Telephone and Telegraph Company, FCC 75-253, released March 6, 1975 (A. 1-28). The Commission's order is not yet reported. This Court has jurisdiction pursuant to 47 U.S.C. 402(a) and 28 U.S.C. 2341-2352.

The relevant background information for this case is not complex. It will be discussed briefly in three parts: the regulatory framework, AT&T's 1975 tariff filing, and the Commission's prior prescription.

I. Regulatory Framework

In enacting Sections 203-205 of the Communications Act, 47 U.S.C. §§203-205, Congress established a specific statutory scheme for dealing with revisions in charges for common carrier services.1/ American Telephone and Telegraph Company v. FCC, 487 F.2d 864, 880 (2d Cir. 1973). The general rule is that revisions are initiated by carriers,

1/ The texts of these statutes are reproduced in the addendum to the petitioner's brief.

pursuant to Section 203, and the Commission may deal with them only within the limitations imposed by these statutes. The Commission may institute hearings into the lawfulness of the proposed charges, and, pending the hearing, suspend the effectiveness of the charges up to 90 days. If the hearings are not completed within that time, the new charges go into effect by operation of law. The carrier may be ordered to keep an account of the increases it collects after the new charges become effective.

At the end of the hearings, the Commission may order refund of any amount of the increase which it finds to be unjustified. 47 U.S.C. §204. In addition, if the Commission finds a charge to be unlawful, it is authorized "to determine and prescribe" what will be a just and reasonable charge (or a maximum or minimum charge, or maximum and minimum charges) to be followed thereafter. 47 U.S.C. §205(a). A prescription binds the carrier to the prescribed charge.

Thus, the regulatory framework in which this case arose permits carriers to initiate rate changes unless there has been a prior prescription. If there has been a prescription, however, the carrier "shall not thereafter publish, demand, or collect any charge other than the charge prescribed. . . ." 47 U.S.C. §205(a). He may be relieved of that obligation and

revise his charges "only with prior Commission permission." American Telephone and Telegraph Company v. FCC, 487 F.2d at 874. See also 47 U.S.C. §408.

II. AT&T's 1975 Tariff Filing

On January 3, 1975, AT&T filed proposed tariff revisions which would have increased the company's interstate revenues by approximately $717 million a year and would have produced an overall rate of return of 10.5 to 11 percent on AT&T's interstate investment. (A. 1, 20, 22, 30, 51.) AT&T acknowledged in its filing and in an accompanying letter to the Commission chairman that the level of earnings it sought was beyond that which the Commission had found to be reasonable in its "rate-of-return decision" in Docket No. 19129.1/ (A. 19, 49-50.) But AT&T asserted that changes in financial and economic conditions since the rate of return decision made the rate increases necessary. (A. 19-22, 48-66.) In the letter to the chairman, AT&T concluded:

> These economic and financial circumstances now require an interstate earnings level of 10.5 to 11 per cent on investment, in order to sustain the financial integrity of the Bell System and to permit the attraction of necessary debt and equity capital under prevailing

1/ American Telephone and Telegraph Company (Docket 19129, Phase I), 38 FCC 2d 213 (1972), recon. denied, 42 FCC 2d 293 (1973). ("Phase I order.")

> conditions in the money markets. Accordingly, we are today filing rates designed to produce interstate earnings within that range.

(A. 20.) 1/

Despite its recognition that the Commission in its recent order had allowed rates which were designed to produce earnings only as high as 8.5 per cent, AT&T neither asked the Commission to modify its rate of return decision nor sought permission to file rates designed to produce a higher return. Instead, it apparently expected the Commission to disregard its own prior rate of return prescription and to treat the tariff proposal as a routine filing under Section 203 of the Communications Act.

A number of parties filed responsive pleadings, many of them asking variously that the Commission reject, cancel or suspend the tariff. (A. ln.1; 5-8.) Six separate petitions urged the Commission to reject the proposed revisions on grounds that they were designed to raise AT&T's

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1/ AT&T also recited increases in operating expenses in justification of its tariff. (A. 18, 19; Br., pp.8-9.) However, expenses are not included in the rate of return calculation. See, e.g., Phillips, The Economics of Regulation, pp. 128-32 (1969). If AT&T had merely sought rate increases to bring its rate of return back to the prescribed level because increased expenses had eroded earnings, the Commission would have been unable to reject on the theory that is attacked here. For purposes of this case, the increases in operating expenses are not a relevant consideration.

rate of return beyond the level prescribed in the Phase I order.1/ In its Reply to these pleadings, AT&T made explicit what had been apparent in its filing: AT&T did not regard the Phase I order as a prescription, it was not seeking a modification of that order or permission to file rate increases, and it expected the Commission to treat its filing as a carrier-initiated rate increase which was to go into effect by operation of law. (A. 418-32.)

The Commission released its order rejecting AT&T's tariff filing on March 6, 1975.2/ The Commission interpreted its own Phase I order as a prescription of AT&T's rate of return at 8.5 per cent. It analyzed the Phase I proceeding this way:

> This action by the Commission was taken after a full evidentiary hearing, during which extensive evidence and exhibits were presented by Bell and other parties. Based upon this

1/ Ad Hoc Telecommunications Committee (representing Bethlehem Steel Corp., Chrysler Corp., Monsanto, Olin Corp. and Westinghouse Corp.), Petition to Reject Tariff Filing (A. 110-19); Aerospace Industries Association of America, Petition to Reject or Suspend Rate Increases (A. 137-64); American Newspaper Publishers Association, Petition to Cancel or, in the Alternative, Suspend and Investigate, and Petition to Reject (A. 283-201); Associated Press, Petition to Cancel or, in the Alternative, Suspend and Investigate (A. 303-16); Commodity News Service, Petition to Cancel or, in the Alternative, Suspend and Investigate (A. 317-26); and United Press International, Petition for Rejection or, in the Alternative, Suspension of Tariff Schedules (A. 381-88).

2/ The Commission had announced its action by news release on February 27, five days in advance of the proposed March 4 effective date of the new rates. (A. 474.)

> extensive record, the Commission determined the prevailing cost of debt and equity for Bell, and established the appropriate rate of return required to cover those costs. This action was a properly determined prescription of Bell's rate of return. The effect of this action was to bar Bell from filing any rate revisions designed to increase its overall rate of return above the 8.5% level without obtaining the Commission's approval to increase this level by demonstrating that the level was no longer adequate.

(A. 9. Footnotes omitted.)

The Commission made clear that it had not prescribed a specific rate structure. AT&T, it said, was free to alter its rate structure so long as it did not increase its overall earnings level above 8.5 per cent. But, the Commission said, the filing of any tariff designed to produce a rate of return in excess of 8.5 per cent "is prima facie unlawful." Because the present filing was designed to produce a rate of return of 10.5 to 11 per cent, it had to be rejected. (A. 10-11.)

The Commission recognized that changes had taken place in the economy since its adoption of the Phase I order and that continued declines in AT&T's earnings could "impact Bell's ability to serve the public interest." Thus, it treated AT&T's filing in part as a request for modification of the prescription and concluded that some modification was in order. Pointing out that AT&T's evidence of increases in its embedded cost of debt was uncontested and

taking official notice of changes in the company's capital structure, the Commission modified its prescription to take those changes into account:

> We thus conclude that the just, fair and reasonable rate of return for Bell, under present conditions, is 8.74%. . . .

(A. 11.) The Commission permitted AT&T to adjust rates accordingly to produce approximately $365 million more a year. 1/ The Commission also initiated an evidentiary hearing into the appropriate levels for AT&T's cost of equity and overall rate of return, to be conducted on an expedited basis and to be completed within nine months. (A. 11 & n.15.)

Thus, although the Commission rejected AT&T's unlawful tariff filing, it (1) granted more than half the increase in revenues that was sought; (2) granted that relief without suspension; (3) placed the rate of return question in hearing again in light of changed circumstances; and (4) ordered the hearing expedited. 2/

1/ AT&T on March 7 filed revisions to produce additional revenues of $365 million a year, effective on March 9. Thus, since March 9, AT&T has been collecting approximately $1 million a day more than it would have gotten until June 4 if the Commission had suspended its tariff the full 90 days permitted by statute.

2/ Several petitions for reconsideration or clarification have been filed with the Commission, but they do not raise the same questions that are presented in AT&T's petition for review.

III. Commission's Prior Prescription

The Commission relied upon its order at the end of Phase I of Docket No. 19129, in which it had prescribed a rate of return of 8.5 per cent. AT&T, 38 FCC 2d 213. The Commission instituted Docket No. 19129 in 1971 to investigate the lawfulness of an earlier tariff filing. AT&T had filed revisions on November 20, 1970, which were designed to increase the company's interstate earnings by $545 million a year and produce a rate of return of 9.5 per cent. AT&T, 27 FCC 2d 151, 152-53 (1971).

Upon consideration of the size of the proposed increase, the Commission by letter dated January 12, 1971, asked AT&T to postpone the effective date of the tariff revisions pending hearings. The Commission stated that its action was taken partly on the basis of its 1967 decision finding that AT&T's allowable rate of return was within the range of 7 to 7.5 per cent, as compared with the 9.5 per cent the company was now seeking. In view of certain changes in circumstances since the 1967 decision, however, the Commission suggested that AT&T consider filing new tariff revisions which would produce additional interstate earnings "not to exceed $250 million."1/ AT&T agreed to the Commission's

1/ Letter from Chairman Dean Burch to AT&T, January 12, 1971.

proposal, postponing the effective date of its rate revisions and filing new increases of $250 million.1/ 27 FCC 2d 151, 153-55.

The Commission then instituted Docket No. 19129, pursuant to Sections 201(b), 202(a), 204, 205 and 403 of the Act, to investigate the lawfulness of the tariff revisions, and suspended the newly filed rates for five days with an accounting order. The issues included whether the Commission should prescribe charges, and, if so, "what charges should be prescribed." The investigation was to proceed in two phases: The rate of return was the prime issue for Phase I, and other issues bearing on AT&T's revenue requirements went into Phase II. The Commission made clear that its Phase I decision might result in "rate adjustments" before the resolution of Phase II issues. 27 FCC 2d 149; 27 FCC 2d 151, 156-57, 161-62.2/

1/ Letter from D.E. Emerson, AT&T vice president, to Chairman Burch, January 13, 1971. In this letter, AT&T strongly urged a two-phase investigation, suggesting that the rate of return be decided first and that new rates be authorized at the end of the first phase:

> In complying with your request, we are doing so on the premise that the expedited hearings will put the rate of return issue first, and that upon determination of this issue by the Commission, appropriate rates will be made effective.

2/ The Commission's limited resources required that an investigation of this scope proceed in phases. At one point in Docket No. 19129, the Commission voted to abandon

(Footnote cont'd on following page.)

At the close of hearings, the presiding hearing examiner concluded in his Initial Decision that the "fair and reasonable" range of interstate earnings for AT&T was between 7.9 and 8.8 per cent, and "current economic conditions justify a rate of return of 8.25% within that range." 41 FCC 2d 389, 449. 1/

The Commission released its final decision on Phase I on November 22, 1972. The Commission's order departed somewhat from the examiner's conclusions (38 FCC 2d at 245.):

> [W]e are of the opinion and so conclude that the fair rate of return to Bell on its interstate and foreign communication services is 8.5%. We consider that this return is the minimum required by Bell to enable it to attract capital at a reasonable cost and to maintain the credit of Bell; and to assure continued, adequate and safe interstate and foreign communications service to the public and to provide for necessary expansion to meet future requirements.

(Footnote cont'd from preceding page.)

Phase II of the investigation because it concluded that it did not have sufficient resources or adequate staff to develop a meaningful record. AT&T, 32 FCC 2d 691 (1971). At the urging of many parties and with new budget allocations, the Commission reconsidered and reactivated the Phase II investigation. AT&T, 33 FCC 2d 269 (1972).

1/ In response to requests by the parties that he also prescribe a specific revenue figure for AT&T, the examiner stated:

> [T]he Examiner has determined to limit the Ordering Clause hereof to the prescription of a fair overall rate of return for Bell System, leaving the procedural complexities involved in prescribing intermediate rate relief for Bell System, or possible adjustments for the ratepayers, entirely to the wisdom of the Commission in the light of the developments, present and future.

41 FCC 2d at 448.

The Commission also adopted "an appropriate range of return by which to measure the reasonableness of Bell's future earnings and revenue requirements." If the company were able, "through improved efficiency or productivity gains," to increase its earnings within a reasonable range above 8.5 per cent, the Commission said, "we should consider such increased earnings to be acceptable without regulatory action on our part." Accordingly, the Commission stated, "we shall specify a range of 8.5-9.0% as the range of reasonableness for the earnings of Bell on its interstate operations at the tariff rates we are allowing Bell to file herein. This is done with the understanding that an earned rate of return within this 8.5-9.0% range at these tariff rates would be considered by us to be reasonable." 38 FCC 2d at 245.

AT&T was permitted to file rates designed to produce $145 million in additional net earnings. At the same time, the Commission cancelled AT&T's original tariff filing of November 20, 1970, which had been predicated on a rate of return of 9.5 per cent. 38 FCC 2d at 251. In total effect, the Commission declared null and void the original $545 million increase, and permitted AT&T to increase its rates by $395 million (i.e., the $250 million increase granted pending the Phase I hearings and the $145 million permitted as a result of Phase I.)

Several parties filed petitions for reconsideration. AT&T, for example, argued that the rate of return was too low; others, that it was too high; and still others, that the Commission should not have permitted any rate increases until it had resolved all the Phase II issues as well. The Commission denied all the petitions and refused to change its "prescription of 8.5-9.0% as the range of reasonableness." 42 FCC 2d at 300.

In response to arguments by the Common Carrier Bureau Trial Staff, which attacked the specific rate schedule filed by AT&T, the Commission made clear that it had prescribed a rate of return rather than a specific rate schedule:

> In our decision of November 22, 1972 we authorized rates which, as of the time of filing, would produce a return of 8.5% - the lower part of the 8.5-9.0% range of reasonableness prescribed by the Decision.... [W]e believe that the rates actually filed meet that objective in a reasonable manner and in fact, actual interstate operating results realized since that filing tend to confirm this judgment. But to the extent that the Trial Staff's argument is to the effect that the filed rates must, under any and all circumstances, produce no more than 8.5%, we cannot agree. For clearly, no revised interstate message toll rate schedule can lay claim to such exactitude.... This, of course, was not the reason for our prescription of 8.5-9.0% as the range of reasonableness. Essentially, that range is intended as our criteria for measuring the reasonableness of AT&T's interstate rates and earnings and the need for adjustment therein. Assuming, therefore, that AT&T's rates were reasonably designed to strike a going level of earnings of 8.5% -- and we believe this to be a reasonable assumption -- our Decision does not prohibit earnings up to 9.0%.

42 FCC 2d at 199-300.

Thus, the Commission made clear that, while it had not prescribed a specific rate schedule, it had prescribed a range of reasonableness for AT&T's rate of return. Rates "reasonably designed" to produce earnings within that range were acceptable; those designed to produce higher returns were in violation of the prescription and would be rejected, just as the Nov. 30, 1970, filing was cancelled.

* * *

The Phase I decision is now before the District of Columbia Circuit for review. Ralph Nader et al. v. FCC and U.S., Nos. 73-1045, 73-2051. In light of the pendency of that case and the fact that one of the issues there is whether the Commission prescribed rates in its Phase I order, the Commission sought by motion to have this case transferred to that Court. The Commission's premise for seeking transfer was that AT&T's petition in this Court raised two issues: (1) whether the Commission has authority under the Communications Act to prescribe a rate of return with future binding effect, so as to permit it to reject tariff filings which seek to raise the rate of return above the prescribed level; and (2) assuming the Commission has such authority, whether its Phase I order was a lawful prescription of AT&T's rate of return.

In oral argument on the transfer motion before a panel of this Court on April 1, 1975, AT&T denied that the second issue was present in this case. In response to persistent questions from the bench, counsel for AT&T stated that the only issue was the Commission' authority, and that AT&T had no disagreement with the Commission as to the Phase I order.1/ The Court denied the Motion to Transfer without prejudice. Order, April 15, 1975.

1/ The Court can verify this account of the proceeding by listening to tape recordings. See also AT&T's Response in Opposition to Motion to Transfer; Intervenor USITA's Response in Opposition to Motion to Transfer.

SUMMARY OF THE ARGUMENT

When the Commission has exercised its prescriptive power under Section 205 of the Communications Act, a carrier is no longer at liberty to initiate rate changes unilaterally in a manner which would abrogate the prescription. Instead, it must seek permission from the Commission before filing tariffs that are inconsistent with the prescription. 47 U.S.C. §§205(a), 408. See, e.g., Permian Basin Area Rate Cases, 390 U.S. 747, 777-84 (1968); AT&T v. FCC, 487 F.2d at 874, 880.

A rate-making agency has wide discretion in determining how to exercise its powers. No particular method of rate regulation is so sanctified as to make other reasonable methods unlawful. Thus, under its authority to prescribe charges pursuant to Section 205, the Commission is not required to limit itself to prescribing specific rate schedules, but may adopt other reasonable means to the same end, so long as the statutory standards are satisfied. Permian Basin Area Rate Cases, 390 U.S. at 767-77. Cf. Federal Power Commission v. Texaco, Inc., 417 U.S. 380 (1974); Wisconsin v. Federal Power Commission, 373 U.S. 294 (1963); Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944).

In particular, the Supreme Court has approved the two-step approach to ratemaking, in which the agency first

prescribes a rate of return and requires interim rate adjustments before resolving other issues. Federal Power Commission v. Tennessee Gas Transmission Co., 371 U.S. 145 (1962); Federal Power Commission v. Natural Gas Pipeline Co., 315 U.S. 575 (1941). This procedure is precisely what the Commission adopted in Docket No. 19129, prescribing a rate of return at the end of Phase I and leaving other issues for later resolution.

This approach to rate regulation is particularly appropriate in view of the overwhelming task of regulating the telephone industry and AT&T in particular. AT&T does business in all 50 states and internationally. Its tariffs cover literally hundreds of different types of services and equipment, and even within the services there are different rates based on such factors as time of day, whether operator assistance is required, and the like. As an example, AT&T's private line tariff alone contains literally thousands of rates. Tariff FCC No. 260 (Private Line Services). The message toll service (MTS) and wide area telephone service (WATS) tariffs are similarly complex. See Tariffs FCC Nos. 263 (MTS) and 259 (WATS). If the Commission is to carry out effectively its functions under Sections 203-205 of the Act, it must have the flexibility to adopt such procedures

as the two-phase approach to ratemaking, so that a rate of return may be prescribed relatively promptly. Compare Area Rate Proceeding (Docket No. AR61-1), 34 FPC 159, 174-80 (1965), aff'd sub nom. Permian Basin Area Rate Cases, 390 U.S. 747.

The Commission fully complied with the requirements of Section 205(a) in prescribing the rate of return. It accorded AT&T a full hearing, found that a rate of return of 8.5 per cent would be fair and reasonable, specified a range of reasonableness within which the company's earnings would be considered reasonable under rates designed to produce an 8.5 per cent rate of return, and permitted AT&T to file an appropriate rate schedule. See AT&T v. FCC, 487 F.2d at 874. In addition, the Commission rejected as "null and void" the tariff filing it was considering in the hearing because it was designed to produce a rate of return that could not be found just and reasonable.

AT&T's subsequent attempt to abrogate the prescription unilaterally by filing rates designed to produce a rate of return above the prescribed level, without seeking the Commission's permission or a modification of the prescription, was unlawful under Sections 205 and 408, and the Commission properly rejected the filing.

ARGUMENT

The Commission does not disagree with AT&T's general position that the "statutory scheme" of the Communications Act calls for carrier initiated rates and limits the Commission's authority for dealing with rate changes. Compare Pet. Br., pp. 15-28, with Resp. Br., pp. 2-4.[1/] AT&T v. FCC, 506 F.2d 612 (2d Cir. 1974). Nor does the Commission claim that its rejection of the tariff in this case was based on a prior prescription of specific rates. Rather, the Commission's justification for the rejection was its prior prescription of a rate of return on the basis of which AT&T was authorized to file rates designed to meet the prescribed level of earnings. AT&T denies that a rate of return can be prescribed or that the Commission's action in Phase I amounted to a prescription.

THE COMMISSION ACTED WITHIN ITS STATUTORY AUTHORITY IN REJECTING AT&T'S TARIFF PROPOSAL, WHICH WAS DESIGNED TO PRODUCE A RATE OF RETURN ABOVE THE LEVEL PRESCRIBED BY THE COMMISSION PURSUANT TO SECTION 205(a) OF THE COMMUNICATIONS ACT.

When a regulatory agency, pursuant to explicit

1/ Indeed, AT&T appears reluctant even to concede that a prescription order under Section 205 alters the scheme of carrier initiated rates. ("The only statutory basis upon which the Commission may even arguably prevent a carrier from initiating rate changes is set forth in Section 205 of the Communications Act." Pet. Br., p. 28 (emphasis added).) The binding effect of a prescription, however, is no longer open to serious challenge. Permian Basin Area Rate Cases, 390 U.S. 747. See AT&T v. FCC, 487 F.2d 864. We do not take AT&T's reluctance as a serious argument against the binding effect of a lawful prescription.

statutory authority, prescribes just and reasonable rates, "these become the only lawful rates and so remain until the further order of the [agency]." United States v. Corrick, 298 U.S. 426 (1936); Arizona Grocery Co. v. Atchison, Topeka and Santa Fe Ry. Co., 284 U.S. 370 (1932). As the Supreme Court said in Arizona Grocery:

> When under [its mandate to prescribe] the Commission declares a specific rate to be the reasonable and lawful rate for the future, it speaks as the legislature, and its pronouncement has the force of a statute.

284 U.S. at 386. See also Permian Basin Area Rate Cases, 390 U.S. at 777-80, where, in construing a statute similar to Section 205, the Court held: 1/

> Nothing in §5(a) imposes limitations of time upon the effectiveness of rate determinations issued under it; rather, the section provides that rates held to be just and reasonable are "to be thereafter observed . . . ."
>
> * * * *
>
> We are, in the absence of compelling evidence that such was Congress' intention, unwilling to prohibit administrative action imperative for the achievement of an agency's ultimate purposes. We have found no such evidence here, and therefore hold that the Commission may under §5 and 16 restrict filings under §4(d) of proposed rates higher than those determined by the Commission to be just and reasonable.

1/ Section 5(a) of the Natural Gas Act, 15 U.S.C. §717d(a), like Section 205(a) of the Communications Act, authorizes the agency to prescribe just and reasonable rates. Section 4(d), 15 U.S.C. §717c(d), like Section 203 of the Communications Act, authorizes carriers to initiate rate changes.

A carrier under a prescription is not without recourse. He may seek permission from the agency to file new rates or petition the agency to modify its prescription. See AT&T v. FCC, 487 F.2d at 874. If he shows sufficient basis for the relief he seeks, it must be assumed that the agency will grant it.[1/] In any event, the agency's action (or unreasonable inaction) on the request would be reviewable. 47 U.S.C. §402(a); 28 U.S.C. §2341 et seq; 5 U.S.C. §706(1).

In the meantime, however, a tariff filing which seeks to abrogate a valid prescription is unlawful on its face, and the proper disposition is rejection. See United Gas Pipe Line Co. v. Mobile Gas Service Corp., 350 U.S. 332 (1956); Associated Press v. FCC, 448 F.2d 1095 (D.C. Cir. 1971) ("a tariff will be rejected if it is unlawful without prior agency approval, and approval has not been obtained"); Municipal Light Boards v. F.P.C., 450 F.2d 1341 (D.C. Cir. 1971) (rejection is appropriate for "a filing that patently

1/ In this case, the Commission granted substantial relief on the basis of AT&T's showing of changed circumstances. It modified the rate of return prescription to reflect an increase in the cost of debt, and it placed the rate of return in an expedited hearing. (A. 11, 12.) AT&T apparently chose to stand on principle and challenge the Commission's power to prescribe a rate of return with binding effect; its own failure to seek permission to file new rates cannot create equities for AT&T when the Commission correctly rejects the unlawful filing.

is either deficient in form or a substantive nullity").[1/]

A. The Commission's Broad Discretion To Choose the Method for Carrying out Its Prescriptive Power Permits It to Prescribe Rates of Return.

Section 205(a), like similar statutes of other regulatory agencies, authorizes the Commission to prescribe just, fair and reasonable charges and practices, "but it does not specify the means by which that regulatory prescription is to be attained." Federal Power Commission v. Texaco, Inc., 417 U.S. 380, 387 (1974). Instead, the courts have held repeatedly that rate-making agencies have broad discretion in choosing the method for prescribing rates. In Wisconsin v. F.P.C., 373 U.S. 294 (1963), for example, the Supreme Court affirmed the Power Commission's decision to experiment with area rate making under a statute that appeared literally to call for individual company

1/ AT&T's reliance on this Court's decision in AT&T v. FCC, 487 F.2d 864 (the "special permission" decision), is misplaced. In that case, the Court struck down a Commission policy of requiring carriers to obtain special permission before filing tariff increases during the pendency of certain proceedings. The Court held that policy to be tantamount to a prescription without the requisite hearing or findings. This, the Court said, would frustrate the "precise statutory scheme" established by Congress. 487 F.2d at 876. The Commission in that case did not base its action on a prior prescription after full hearing and the requisite statutory findings, as it does here. In fact, it explicitly denied that any prescription was involved. 487 F.2d at 874 & n.20. The Court also contrasted the Commission's action in that case with the Power Commission's refusal to accept tariff changes in the Permian Basin Area Rates Cases after a valid prescription had been made. This Court recently rejected another attempt by AT&T to invoke the "special permission" case in support of a proposition it did not advance. See AT&T v. FCC, 503 F.2d 612, 617-18.

cost-of-service regulation. The Court stated:

> [T]o declare that a particular method of rate regulation is so sanctified as to make it highly unlikely that any other method could be sustained would be wholly out of keeping with this Court's consistent and clearly articulated approach to the Commission's power to regulate rates. It has repeatedly been stated that no single method need be followed by the Commission in considering the justness and reasonableness of rates . . . .

373 U.S. at 309 (citations omitted). This was consistent with a line of Supreme Court decisions holding that "[u]nder the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling." Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 602 (1944).

In the landmark Permian Basin Area Rate Cases, the Supreme Court gave its final approval to the Power Commission's choice of the area rate "method" of regulating natural gas companies. The Court relied upon both the statute dealing specifically with the prescriptive power and the general statute authorizing the Commission "to perform any and all acts, and to prescribe . . . such orders, rules, and regulations as it may find necessary or appropriate to carry out the provisions" of the Act.[1/] In language that bears directly on the present controversy, the Court stated:

1/ The prescription statute is Section 5(a), and the general powers statute is Section 16, 15 U.S.C. §717o. Footnote 1 p. 20, supra.

> This Court has repeatedly held that the width of administrative authority must be measured in part by the purpose for which it was conferred . . . . Surely the Commission's broad responsibilities therefore demand a generous construction of its statutory authority.
>
> Such a construction [illegible]nsistent with the view of administrati[illegible]te making uniformly taken by this Court[illegible]e Court has said that the "legislat[illegible] discretion implied in the rate making power necessarily extends to the entire legislative process, embracing the method used in reaching the legislative determination as well as that determination itself." . . . . It follows that rate-making agencies are not bound to the service of any single regulatory formula; they are permitted, unless their statutory authority otherwise plainly indicates, "to make the pragmatic adjustments which may be called for by particular circumstances." . . .
>
> We are unwilling, in the circumstances now presented, to depart from these principles. The Commission has asserted, and the history of producer regulation has confirmed, that the ultimate achievement of the Commission's regulatory purposes may easily depend upon the contrivance of more expeditious administrative methods . . . . We cannot, in these circumstances, conclude that Congress has given authority inadequate to achieve with reasonable effectiveness the purposes for which it has acted.

390 U.S. at 776-77 (citations and footnotes omitted).

We have quoted extensivly from the Permian Basin decision because of the striking similarities between that case and the one now before this Court. In both cases,

an agency attempted to deal in a practical manner with an overwhelming rate-making problem.[1/]

In both cases also, the method chosen by the Commission was attacked as inconsistent with the terms of the governing statutes. Yet, the FCC like the FPC was merely exercising its broad discretion to choose the method for carrying out its undisputed statutory obligation to prescribe rates. We submit that the Permian Basin decision requires affirmance of the Commission's action here.

The Supreme Court also has held specifically that rate-making agencies have discretion to conduct their proceedings in phases, adjusting rates at the end of a rate of return phase before deciding other questions. Federal Power Commission v. Tennessee Gas Transmission Co., 371 U.S. 145 (1962); Federal Power Commission v. Natural Gas Pipeline Co., 315 U.S. 575 (1941). The Tennessee Gas Co. Court found that the "two-step" approach to rate prescription,

1/ Compare the Commission's decision at one point to abandon its Docket No. 19129 proceeding for lack of sufficient resources, 32 FCC 2d 691, with the Supreme Court's acknowledgment of the practical impossibility of dealing with gas rates on an individual company basis, 390 U.S. at 757 n.13. The FCC does not deal with numerous companies; its administrative burden arises from the complexity of voluminous rate schedules covering numerous routes and services. As a practical matter, interim rate of return regulation appears to be a means of coping with the FCC's rate-making responsibilities. See p. 17 , supra.

in which the issue of a fair rate of return was decided first with binding effect, "was not only entirely appropriate but in the best tradition of effective administrative practice." 371 U.S. at 155.

This Commission's decision to proceed in two phases in Docket No. 19129 similarly was "effective administrative practice." This approach was urged by AT&T, among others. Letter from D.E. Emerson to Chairman Dean Burch, p.10 , n.1 , supra.[1/] Determination of a just and reasonable rate of return insures that the carrier will not be deprived of the funds it needs to continue to provide service and make necessary improvements. At the same time, it protects the consumer from overreaching. Finally, it permits the agency to make a decision within a reasonable time period that goes far toward satisfying its obligation to insure just, fair and reasonable rates.

1/ AT&T had suggested a similar procedure at least once before, in the Commission's lengthy Private Line Rate Cases, 34 FCC 217 (1963), aff'd sub nom. Wilson & Company, Inc. v. U.S. and FCC, 335 F.2d 788 (7th Cir. 1964). AT&T urged the Commission in that case to limit itself to determining the company's rate of return and revenue requirement, leaving the complexities of specific rates to the carrier. 34 FCC 2d at 228. The Commission in that case declined to leave the specific rates to AT&T.

To be sure, Section 205 makes no specific mention of rate of return,[1] just as Section 5(a) of the Natural Gas Act makes no mention of area rates. But the Commission's action was consistent with the provisions and purposes of Section 205; and, like the Power Commission, the FCC finds additional support in a general statute authorizing it to perform "any and all acts . . . not inconsistent with this Act, as may be necessary in the execution of its functions." 47 U.S.C. §154(i) (emphasis added).[2] Cf. GTE Service Corporation v. FCC, 474 F.2d 724 (2d Cir. 1973).

1/ Rate of return is an essential element of all rate regulation, however, and a rate-making agency clearly has the authority to decide what rate of return will be permitted. See generally, Trebing and Howard, Rate of Return under Regulation (1969).

2/ The argument of Intervenor USITA that prescription of a rate of return is a "practical impossibility" ignores the status that has existed since the Commission issued its Phase I order. AT&T had no difficulty filing a rate schedule designed to produce 8.5 per cent, and the Commission is unaware of any substantial departures from the prescribed return. The Commission conceded that rate of return prescriptions lack the "exactitude" of specific rates. 42 FCC 2d at 300. But that does not diminish the practical value of a device which carries out the Commission's regulatory obligation while permitting the carrier to have maximum flexibility in determining his rate schedule.

B. The Commission's Phase I Order Was A Lawful and Proper Exercise 1/ Of Its Authority Under Section 205.

In designating AT&T's 1970 tariff filing for hearing in Docket No. 19129, the Commission recited Section 205 as authority for the proceeding and designated the following among the issues:

> 1. What are the revenue requirements of the Bell System Companies applicable to their interstate and foreign communications services and the basis upon which such revenue requirements are to be determined, including:
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> * * *
>
> B. The fair rate of return required by the Bell System on the amounts of net investment . . . .
>
> * * *
>
> 6. Whether the Commission should prescribe just and reasonable charges or maximum or minimum or maximum an minimum charges to be hereafter followed with respect to message toll telephone service, and, if so, what charges should be prescribed.

1/ The Commission respectfully submits that this issue is not properly before the Court. AT&T's argument in opposition to the Commission's Motion to Transfer (see pp. 14-15, supra), in which it urged that the sole issue in the case was the Commission's authority to prescribe a rate of return with binding effect, waived any right to argue on the merits that other issues also are involved. The Commission believes that its Phase I prescription order can withstand the closest judicial scrutiny; but it urges the Court not to permit AT&T to take contradictory positions on the basic question of what is before this Court for review. Because the parties will have briefed this case fully and made oral arguments by June 11, the Commission will not renew its motion to transfer.

27 FCC 2d at 161, 162. The Commission held extensive hearings in Phase I, devoted primarily to the rate of return. In its order it concluded that the "fair rate of return" for AT&T was 8.5 per cent, and that the range of 8.5 to 9 per cent was the "range of reasonableness" for AT&T's earnings. 38 FCC 2d at 245. It rejected as "null and void" the 1970 tariff filing, which sought a return that was beyond the range of reasonableness. 38 FCC 2d at 251. And it permitted AT&T to file its own schedule of rates reasonably designed to produce a return of 8.5 per cent. 38 FCC 2d at 251, 42 FCC 2d at 300.

The rates AT&T was authorized to file were calculated to produce $145 million a year, on the basis of AT&T's current plant investment and cost with the 8.5 per cent return applied. AT&T was authorized to file for an increase of that size and no more. Thus, as the Commission had stated in its designation order, AT&T was permitted to adjust its rates at the end of Phase I in accordance with the prescribed rate of return. 27 FCC 2d at 157.

The essential elements of a prescription order are a full opportunity for hearing and a finding that the rates prescribed are just and reasonable. AT&T v. FCC, 487 F.2d at 874, quoting AT&T v. FCC, 449 F.2d 439, 450 (2d Cir.

1971). See also National Association of Motor Bus Owners v. FCC, 460 F.2d 561, 563 (2d Cir. 1972). AT&T clearly had a full opportunity for hearing in Phase I, and we do not understand it to deny the adequacy of the evidence to support the findings. Similarly, the Commission made the requisite findings that the prescribed rate of return was fair and reasonable and that 8.5 to 9.0 per cent was a range of reasonableness.[1/] No more is required under the statute or applicable case law.

AT&T argues, however, that the Commission's Phase I order was inconsistent with a prescription theory because it also ordered an accounting with a view toward refund of any amounts subsequently found unjustified. It cites the Arizona Grocery case for the proposition that there can be

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1/ Fair and reasonable surely is an adequate substitute for just and reasonable. As this Court has recently stated in two cases involving the same parties as this one, "[T]o determine whether rates have been prescribed the actual impact of agency action and not its form is decisive." AT&T v. FCC, 487 F.2d at 874, quoting AT&T v. FCC, 449 F.2d at 451 & n.12. See also Moss v. CAB, 430 F.2d 891 (D.C. Cir. 1970), where the Court held that, contrary to the agency's view, a prescription had occurred. In any event, the concept of a fair rate of return is fundamental to rate regulation. The Commission's finding is thus consistent with a line of cases, extending from the beginnings of rate regulation in this country. E.g., Federal Power Commission v. Natural Gas Pipeline Co., 315 U.S. 579; Bluefield Water Works v. Public Service Commission, 262 U.S. 668, 690 (1923); Smyth v. Ames, 169 U.S. 466, 547 (1898).

no refund orders as to "agency-made" rates. 284 U.S. at 386, 390. This argument ignores the distinction between prescribing specific rates and level of earnings. Here, the earnings level was prescribed while the specific rates were "carrier made" (A. 10 n.14), so that any unjustness, unreasonableness or discrimination may lawfully result in refund orders. Phase II continues, and these questions may not be resolved finally until the Commission completes the entire docket. What the Commission prescribed was the rate of return, and only that prescription has binding effect on AT&T. 1/

Finally, AT&T's argument that the Phase 1 order had no binding effect requires the conclusion that the entire proceeding was a nullity. Days of hearings, volumes of evidence and transcripts, two oral arguments before the Commission--all would be reduced to a meaningless exercise which could be set aside the next day by a "carrier-initiated"

1/ AT&T's recitation of the Power Commission's policy toward rate of return findings (Pet. Br., pp. 39-40 n. 55) is not persuasive. The Power Commission may have no regulatory objective that would be served by issuing binding rate of return prescriptions, just as the FCC has no regulatory purpose for area rate making. Moreover, the Power Commission's policy does not suggest that a contrary policy would be unlawful.

rate filing pursuant to Section 203. Sections 205 and 408 of the Communications Act explicitly preclude any such frustration of regulatory action by the Commission. As Judge Learned Hand said more than 30 years ago in resolving a similar argument in an important Commission case, "It would be futile after the expenditure of so much time and labor to hold that the proceedings were only advisory and concluded nobody . . . ." National Broadcasting Company v. United States, 47 F. Supp. 940, 945 (S.D.N.Y. 1942), aff'd, 319 U.S. 190 (1943).

CONCLUSION

The Commission's rejection of AT&T's 1975 tariff filing was a proper exercise of its discretion under the regulatory scheme for common carriers. AT&T's filing, which sought unilaterally to abrogate a valid and lawful prescription of a rate of return for the company, was unlawful on its face and was properly rejected.

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IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

AMERICAN TELEPHONE AND TELEGRAPH COMPANY, Petitioner,	)	
v.	)	No. 75-4046
FEDERAL COMMUNICATIONS COMMISSION and UNITED STATES OF AMERICA, Respondents.	)	
COMMONWEALTH OF PENNSYLVANIA, AIR TRANSPORT ASSOCIATION OF AMERICA and AERONAUTICAL RADIO, INC., AEROSPACE INDUSTRIES ASSOCIATION OF AMERICA, INC., MICROWAVE COMMUNICATIONS, INC. and MCI TELECOMMUNICATIONS CORPORATION, UNITED STATES INDEPENDENT TELEPHONE ASSOCIATION, UNITED PRESS INTERNATIONAL, INC., AMERICAN NEWSPAPER PUBLISHERS ASSOCIATION, THE ASSOCIATED PRESS, COMMODITY NEWS SERVICES, INC., GENERAL TELEPHONE COMPANY OF CALIFORNIA, et al., MUTUAL BROADCASTING SYSTEM, INC., Intervenors.	)	

CERTIFICATE OF SERVICE

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